

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
LEO J. SHANAHAN & SONS, I&C.)

Appearances:

For Appellant: Kenneth Leventhal and Bernard
Lemlech, Certified Public Accountants

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Leo J. Shanahan & Sons, Inc., to a proposed assessment of additional franchise tax in the amount of \$3,427.22 for the taxable year 1957.

Appellant was engaged in the construction and sale of houses. It filed its returns on a calendar year basis. The profit from the sale of most of the houses was reported by the installment method. Under that method, a taxpayer reports as income for each year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price. (Rev. & Tax. Code, §§ 24667 and 24668.) At the close of the year 1956, Appellant had \$85,665.57 in unrealized profits on its installment obligations. During the year 1957, \$44,332.44 was realized, leaving a balance of \$41,333.13 in unrealized profits. On January 2, 1958, all of Appellant's stock was purchased by Central Land Co. for \$25,000 cash and \$12,321.35 in promissory notes. On the same day, Appellant's Board of Directors adopted a plan of liquidation and completely liquidated Appellant. Central Land Co. received all of Appellant's assets, which consisted almost entirely of the installment obligations. The purchase price of the stock was apportioned by Central Land Co. as follows:

Installment obligations		\$49,287.53
Cash		<u>7.17</u>
		49,294.70
Less Liabilities assumed		
Accounts payable	\$945.00	
Federal income tax	11,028.35	
		<u>11,973.35</u>
		\$37,321.35

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It is conceded that Appellant did no business in 1958.

In reliance upon Section 24672 of the Revenue and Taxation Code, the Franchise Tax Board has included in Appellant's income for the income year 1956, as a measure of the tax for the taxable year 1957, the sum of \$85,665.57 as "unreported income" from installment contracts. That section provides in part that:

Where a taxpayer elects to report income arising from the sale or other disposition of property, ... [on the installment basis], and the entire income therefrom has not been reported prior to the year that the taxpayer ceases to be subject to the tax measured by net income ..., the unreported income shall be included in the measure of the tax for the last year in which the taxpayer is subject to the tax ...

Appellant's initial argument is that:

Since Appellant was doing business in California during the entire year of 1957 it was "subject to the tax measured by income" during that year, and did not cease to be subject to said tax until 1958. Therefore, the sum of \$44,332.44 was reported prior to the year that the taxpayer ceased to be subject to the tax. Accordingly, Section 24672 cannot be applied to this income.

Appellant has conceded that it did no business in 1958. Thus, 1957 was the last year in which Appellant was subject to the tax measured by net income. (Rev. & Tax. Code, § 23151.) It follows under Section 24672 that the installment income of \$44,332.44 which was received in the year 1957 was properly included in the measure of the tax for that year as income which was not reported prior to the year that Appellant ceased to be subject to the tax measured by net income.

It is next argued by Appellant that the sum of \$41,333.13 in unrealized and unreported profits from installment obligations at the end of 1957 should be excluded from the measure of the tax. This argument is based upon Section 24670 of the Revenue and Taxation Code, which provided in part during the period in question that:

(c)(1) If -

(A) An installment obligation is distributed by one corporation to another corporation in the course of a liquidation; and

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(B) Under Section 24502 (relating to complete liquidations of subsidiaries) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation;

then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation.

We have previously held that Section 24670 must be taken into consideration in determining the amount of "unreported income" within the meaning of section 24672, supra. (Appeal of Contractors Investment Co., Cal. St. Bd. of Equal., Jan. 5, 1961, CCH Cal. Tax Rep. Par. 201-676, 2 P-H State & Local Tax Serv. Cal. Par. 1324.0; Appeal of Pioneer Development Co., Cal. St. Bd. of Equal., Jan. 5, 1961, CCH Cal. Tax Rep. Par. 201-679, 2 P-H State & Local Tax Serv. Cal. Par. 13241; Appeal of Edside Bldg. Co., Cal. St. Bd. of Equal., Nov. 6, 1961; CCH Cal. Tax Rep. Par. 201-840, 2 P-H State & Local Tax Serv. Cal. Par. 1.3262.) In each of those cases, however, the event that triggered the operation of Section 24670 occurred in the taxable year in which Section 24672 **was** applicable. Here, Section 24672 **was** applicable to the taxable year 1957 and the event that might have required reconciliation with Section 24670, the distribution of the installment obligations, did not occur until the following year. The operation of Section 24672 as to the measure of the tax for 1957 was completed at the end of that year and Section 24670 cannot be given effect.

It is our conclusion that, pursuant to Section 24672, the sum of \$41,333.13 in accrued but unreported profits at the end of 1957, as well as the installment income of \$44,332.44, which was actually received in 1957, must be included in the measure of the tax for that year.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code that the action of

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the Franchise Tax Board on the protest of Leo J. Shanahan & Sons, Inc., to a proposed assessment of additional franchise tax in the amount of \$3,427.22 for the taxable year 1957 be and the same is hereby sustained.

Lone at Sacramento, California, this 19th day of March, 1963,
by the State Board of Equalization.

John W. Lynch, Chairman
Geo. R. Reilly M e m b e r
Paul R. Leake, Member
Richard Nevins, Member
 , Member

ATTEST: Dixwell L. Pierce, secretary